QUESTIONS PRESENTED.

1. Where the jurisdiction of the federal court is based solely on diversity, may the federal Arbitration Act be constitutionally applied, as substantive federal law, to alter state-created rights, by enforcing an arbitration provision contained in a license agreement, where the agreement was in all other respects governed by state law, and where the applicable state law was contrary to the federal law applied by the court below?

2. Where petitioners made a written disclosure of a trade secret and, by a separate contemporaneous written agreement, granted respondent an exclusive license to research and develop same, does such an agreement constitute a contract evidencing a transaction involving commerce so as to make applicable the federal Arbitration Act, merely because the license granted to respondent was restricted to use in the pharmaceutical industry, petitioners having reserved all other areas of use to themselves?

3. Does the federal Arbitration Act require the federal court to enforce an arbitration provision contained in an agreement licensing a secret formula and process, where the sole basis of the federal court's jurisdiction is diversity, and the applicable state law would not enforce such arbitration provision, especially when the parties had agreed that state law should apply to such provision?

4. Since the federal Arbitration Act, as a prerequisite to its enforcement, requires that there be an issue referable to arbitration, may it be invoked in the absence of allegation and proof that such issue exists?

5. In a suit arising from the confidential disclosure of a trade secret, containing a count for a breach of trust thereof, and another count for the breach of an agreement licensing its use, may the Federal Arbitration Act, which limits its application to issues arising under an agreement in writing, be enlarged to apply to the non-contractual issue?

STATUTORY PROVISIONS INVOLVED

9 U. S. C.

§ 1. "Maritime transactions" and "commerce defined"; exceptions to operation of title.

* * * "commerce", as herein defined, means commerce among the several States or with foreign nations, or in any Territory of the United States or in the District of Columbia, or between any such Territory and another, or between any such Territory and any State or foreign nation, or between the District of Columbia and any State or Territory or foreign nation, * * * July 30, 1947, c. 392, § 1, 61 Stat. 669.

§ 2. Validity, irrevocability, and enforcement of agreements to arbitrate.

A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract. July 30, 1947, c. 392, § 1, 61 Stat. 669.

§ 3. Stay of proceedings where issue therein referable to arbitration.

If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance

with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration. July 30, 1947, c. 392, § 1, 61 Stat. 669.

§ 4. Failure to arbitrate under agreement; petition to United States court having jurisdiction for order to compel arbitration; notice and service thereof; hearing and determination.

A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any court of the United States which, save for such agreement, would have jurisdiction under the judicial code at law, in equity, or in admiralty of the subject matter of a suit arising out of the controversy between the parties, for an order directing that such arbitration proceed in the manner provided for in such agreement. * * * July 30, 1947, c. 392, § 1, 61 Stat. 669.

STATEMENT.

This is a civil action, jurisdiction of the district court being founded upon diversity of citizenship and amount, under 28 U. S. C. § 1332.

Petitioners, citizens of the State of Illinois, instituted this action against respondent, a Pennsylvania corporation, in the United States District Court for the Eastern District of Pennsylvania. The complaint (4a-7a), alleged that by written agreement, dated July 1952, petitioners granted to respondent an exclusive license for the use of a trade secret (par. 5, [4a]), and in addition, confidentially disclosed, in writing, the components of the trade secret (pars. 6 and 7, [5a]). Further alleging a breach of the confidential disclosure, and of the agreement, petitioners demanded an accounting and damages in two separate and distinct counts: (1) for breach of contract (par. 12, [6a]); and (2) misappropriation of the trade secret (par. 13, [6a]).

The agreement, copy of which was attached to the Complaint as Exhibit "A" (7a-15a), concedely was executed in Illinois, and grants an exclusive license to respondent for use in the pharmaceutical industry (Exhibit "A", pars. 1 and 2 [8a]), and provides for the contemporaneous and separate written disclosure of the trade secret (Exhibit "A", pars. 4 [9a] and 8 [10a]). The license for the trade secret is restricted to the pharmaceutical industry, petitioners reserving unto themselves the right to license others for use in connection with other products (Exhibit "A", par. 2 [8a]). The agreement further provided that in the event a dispute arises between the parties, from, out of, or concerning the meaning, construction, interpretation, performance, non-performance or breach of the agreement, the same "shall be submitted to arbitration in the County of Cook, City of Chicago and State of Illinois, pursuant to the Arbitration Laws of the State of Illinois, and the then rules of the American Arbitration Associa-

tion'' and that any award shall be enforceable in any court of competent jurisdiction (par. 15 [13a]).

Respondent did not answer the complaint, but filed a motion to stay proceedings pursuant to the Arbitration Act, 9 U. S. C. § 3 (16a-17a).

The district court granted the motion (21a). In his Opinion (18a-21a), the district judge, after reciting the contract provides a license for the use of the material in the ''pharmaceutical industry,'' and taking ''judicial notice of the fact that the pharmaceutical industry covers the entire United States,'' reasoned the contract was one which provides for the supplying of material to an industry which is countrywide, and concluded the contract was one which evidences a transaction involving ''commerce.'' 185 F. Supp. 317, 319.

The Court of Appeals for the Third Circuit dismissed petitioner's appeal on the ground that the district court's order staying proceedings until the conclusion of arbitration was not an appealable order (22a-29a). 300 F. 2d 133.

Arbitration followed, as a result of which petitioners filed a motion in the district court to vacate, modify or correct the award of the arbitrator (44a-47a). This motion asserted, *inter alia,* the non-enforceability of the arbitration provision of the agreement, and the inapplicability, by interpretation and under the Constitution, of the federal Arbitration Act (44a-45a), points which had been raised on the appeal originally from the district court's order. Respondent filed a motion to confirm the award of the arbitrator (48a).

The district court denied petitioners' motion to vacate the award and confirmed the award (55a). In so doing, it refused to disturb, but agreed with, the conclusions of the earlier district court decision staying the proceedings until arbitration should be had (51a).

On appeal, the court of appeals affirmed, *per curiam,* stating no reasons for its determination (Appendix, *infra,* p. 2A).

REASONS FOR GRANTING THE WRIT.

1. This case raises important constitutional questions mentioned, but unresolved, in *Bernhardt v. Polygraphic Co.*, 350 U. S. 198.

A writ of certiorari was issued by this Court in *Robert Lawrence Co. v. Devonshire Fabrics, Inc.*, 271 F. 2d 402 (C. A. 2), to review like constitutional questions projected by the decision replacing state-created rights with federal law, in a diversity case, an area theretofore regarded as one of local character. By stipulation of the parties, the writ was dismissed, 364 U. S. 801.

Moreover, interpretation of the Arbitration Act, 9 U. S. C. §§ 1 et seq, as creating substantive federal rights, thus eliminating the need to determine local law, immediately brings into question the scope of such authority under the national power to regulate commerce, the sole basis assigned for the imposition of federal law here. As noted in *Bernhardt v. Polygraphic Co., supra,* p. 202, serious constitutional implications arise in the light of *Erie Railroad Co. v. Tompkins,* 304 U. S. 64 and *Guaranty Trust Co. v. York,* 326 U. S. 99, where, as here, the jurisdiction of the federal court rests solely upon diversity.

Conflicting views in the courts of appeals appertain. *Cf. American Airlines, Inc. v. Louisville and Jefferson County Air Board,* 269 F. 2d 811 (C. A. 6), with *Robert Lawrence Co. v. Devonshire Fabrics, Inc.*,[2] *supra,* and *Ross v. Twentieth Century Fox Film Corp.*, 236 F. 2d 623 (C. A. 9); see also, *Deep South Oil Co. v. Texas Gas Corp.*, 328 S. W. 2d 897, 906 (alternative holding). The issues have merited academic discussion further reflecting the con-

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2. The court recognized the importance of the questions left open in *Bernhardt v. Polygraphic Co., supra,* but disagreed with the concurring opinion of Mr. Justice Frankfurter, that, to avoid vexing constitutional questions, the U. S. Arbitration Act must be held wholly inapplicable to diversity cases. *Robert Lawrence Company v. Devonshire Fabrics, Inc., supra,* 271 F. 2d at 407.

trariety of opinion with respect to conflicting state-federal and constitutional policies. See, e.g. 69 Yale L. J. 847, 865; 45 Cornell L. Q. 831; 56 Col. L. Rev. 902; 73 Harv. L. Rev. 1382; Kochery, *The Enforcement of Arbitration Agreements in the Federal Courts,* 39 Cornell L. Q. 74; *Sturges and Murphy, Some Confusing Matters Relating to Arbitration Under the United States Arbitration Act,* 17 Law and Contemp. Prob. 580.

2. The absence of an explanatory opinion by the court of appeals here, and the reliance of the district court (20a), 185 F. Supp. at 319, n. 5, upon *Robert Lawrence, supra,* indicates subscription to its principles, for the courts below in this case did not attempt to ascertain the state law applicable hereto.[3] Of course, one way to minimize the constitutional problems is, as was done in *Robert Lawrence, supra,* to hold that federal substantive law applies. See, Bickel and Wellington, *Legislative Purpose and the Judicial Process: The Lincoln Mills Case,* 71 Harv. L. Rev. 1, 34. If the Arbitration Act is interpreted to create federal substantive law, state courts presumably could not decline to enforce it.[4] Thus, the result is to minimize the consequences of *Erie* by giving the Act a different and broader

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3. Petitioner contended below that the applicable law is that of the State of Illinois, and that Illinois law would not enforce an agreement to arbitrate in the future. *Cocalis v. Nazlides,* 308 Ill. 152, 139 N. E. 95; *McKenna Process Co. v. Blatchford Corp.,* 304 Ill. App. 101, 25 N. E. 2d 916; *Hill v. Mercury Record Corp.,* 26 Ill. App. 2d 350, 168 N. E. 2d 461, 465-466. Respondent asserted that the Illinois law was changed by statute, Act of Aug. 24, 1961, Laws 1961, p. 3844, § 1. However, the Act specifically provides that it shall apply only to agreements made subsequent to its effective date. Act of Aug. 24, 1961, Laws 1961, p. 3844, § 19. Since the effective date of the Act was August 24, 1961, and the agreement here involved was made in 1952, the law of Illinois prior to the Act is applicable.

Moreover, the agreement of the parties to submit disputes to arbitration "pursuant to the Arbitration Laws of the State of Illinois" (Exhibit "A" par. 15, [12a], required application of Illinois law. See, *Lauritzen v. Larsen,* 345 U. S. 571, 588-9.

4. But see *Dice v. Akron,* C. & Y. R. Co., 342 U. S. 359, 363.

effect than to regulate federal procedure as the Congress intended.[5] Nothing in the Arbitration Act, or its legislative history, warrants the emasculation of state law in this area, otherwise minimal in its national consequences. Verbal cosmetics will not disguise the fact that the Arbitration Act, as construed by *Robert Lawrence* performs a function neither intended nor envisaged by the Congress. Whether such construction is in accord with the Act and the Constitution, or whether it ought to be tolerated as an exercise of judicial legislation, presents a question of national significance which has not been, but ought to be, resolved by your Honorable Court.

3. A threshold question in this case is whether the agreement here between the parties is a contract "evidencing a transaction involving interstate commerce" within the meaning of 9 U. S. C. § 2. In light of the fact that the courts are in disagreement as to the meaning and proper application of the statutory language[6], the short shrift of a per curiam decision is hardly explicable.

Petitioners submit that the agreement licensing a trade secret is not a contract evidencing a transaction involving interstate commerce. It pertains, rather, to a secret formula and process and comprehends research and development thereof. Such an agreement is not unlike an agree-

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5. H. R. Rep. No. 96, 68th Cong. 1st sess. 1 (1924); S. Rep. No. 536, 68th Cong. 1st sess. 3 (1924). *Red Cross Lines v. Atlantic Fruit Co.*, 264 U. S. 109 (1924), was relied upon as declaring the purely procedural quality of arbitration, thus reflecting the understanding that the Arbitration Act was to regulate procedure in the federal courts.

6. In *Metro Corporation v. Terminal Construction Co.*, 287 F. 2d (C. A. 2) cert. den. 368 U. S. 817, the majority looked to actual performance under a painting contract to find interstate commerce, but the minority (287 F. 2d, at 387) looked to the intent of the contracting parties at the time of entering into the agreement. *Cf. John W. Johnson, Inc. v. 2500 Wisconsin Ave.*, 231 F. 2d 761, 764 (C. A. D. C.), holding that a contract to paint a building does not involve interstate commerce.

ment licensing a patent, which has been construed as not evidencing a transaction involving commerce. *Cold Metal Products Co.*, 9 F. Supp. 992 (D. C. D. Pa.).

To arrive at the conclusion of "a transaction involving commerce" the district court simply noted the contractual reference to the "pharmaceutical industry," and took "judicial notice" that the industry is nationwide, and, therefore, substantial interstate activity was involved. But first, the reference to "pharamceutical industry" was purely a limitation upon the exclusive license granted to respondent. Second, it furnished no support or warrant for the conclusion of substantial interstate activity. Third, by taking "judicial notice" that the industry was nationwide and concluding interstate commerce would result, the court, on this pivotal issue, denied petitioners a hearing, at which relevant facts, if deemed necessary, could have been produced.

It is apparent that the district court telescoped the licensing agreement with the possible ultimate business of the respondent. If interstate commerce was involved at all, it was only in respondent's business, and not in the transaction which the contract here in issue evidenced. The contract here did not, like that in *Robert Lawrence,* involve the purchase and movement of merchandise in interstate commerce. Only by altering the language of the Arbitration Act, so that it expressly applies to contracts evidencing transactions which *might affect* interstate commerce can the conclusion of the court below find support.

The issue is patently one of paramount importance. Not merely are the courts in conflict as to the contracts embraced within the Arbitration Act, but upon this question may rest the line of division between state and federal law. That line should be delineated by this Court.

4. The district court ordered a stay of proceedings pending arbitration though there was nothing before it to warrant the conclusion that there was an issue to arbitrate,

which is one of the mandatory requirements of Section 3 of the Act. Respondent's motion (16a) does not assert any issue or that there is one. The opinion of the judge of the district court does not indicate that he considered this important requirement. If, by his silence it is deemed that he was satisfied of the existence of an arbitrable issue, to this extent, petitioners have been deprived of a hearing at which relevant facts in contravention could have been produced.

5. The district court manifestly misinterpreted Section 3 of the Act as extending its jurisdiction to issues set forth in petitioners' complaint arising from non-contractual rights and obligations.

Exhibit "A" attached to the complaint provides for the separate and contemporaneous disclosure of a trade secret (par. 4, [9a]). The complaint alleges the disclosure of said trade secret in confidence (pars. 6, 7, and [5a]), that respondent violated its confidence by conversion and misappropriation (par. 9, [5a])—these allegations being the basis of the relief sought under Count 2 of plaintiffs' action (6a). The violation of the trust relationship by respondent gave certain rights to petitioners, unaffected by contractual or other considerations. *Dupont v. Masland,* 244 U. S. 100.

Section 3 of the Act limits its enforcement to suits "upon any issue referable to arbitration under an agreement in writing for such arbitration." By enlarging the scope of the Act to include the cause of action for violation of the trust relationship, which is separate and distinct from the rights for breach of contract, the court deprived petitioners of a hearing at which their rights on this case of action might have been determined.

CONCLUSION.

For the foregoing reasons, petitioners respectfully pray your Honorable Court issue a writ of certiorari to review the judgment of the court below.

Respectfully submitted,

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APPENDIX.

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT.

No. 15254.

LEON KIRSCHNER AND HENRY NAFTULIN, INDIVIDUALLY AND AS CO-PARTNERS, TRADING AS K-N ENTERPRISES,

Appellants,

v.

WEST COMPANY

(D. C. Civil No. 27579)

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA

Present: BIGGS, *Chief Judge,* and MARIS and KALODNER, *Circuit Judges.*

JUDGMENT.

This cause came on to be heard on the record from the United States District Court for the Eastern District of Pennsylvania and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the said District Court, filed January 15, 1965, be, and the same is hereby affirmed, with costs.

ATTEST:
IDA O. CRESKOFF,
Clerk.

November 10, 1965

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 15254

LEON KIRSCHNER AND HENRY NAFTULIN, INDIVIDUALLY AND AS CO-PARTNERS, TRADING AS K-N ENTERPRISES,

Appellants,

v.

WEST COMPANY

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA

Argued September 17, 1965

Before BIGGS, *Chief Judge,* and MARIS and KALODNER, *Circuit Judges*

OPINION OF THE COURT.

(Filed November 10, 1965)

PER CURIAM.

We have examined the record in this case and have considered the arguments of the parties. We can perceive no error in the decision of the court below and consequently it will be affirmed upon the opinion of Judge Luongo, — F. Supp. — (E.D. Pa. 1965).